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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 3

ESTATE OF SIDNEY M. SPIEGEL, DECEASED, KATHERINE J. SPIEGEL AND ROBERT MICHELS, SURVIVING EXECUTORS UNDER THE LAST WILL AND TESTAMENT OF SIDNEY M. SPIEGEL, DECEASED,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY BRIEF ON REARGUMENT.

HERBERT A. FRIEDLICH,
LEO F. TIERNEY,
HARRY THOM,
LOUIS A. KOHN, and
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PETITIONERS' REPLY BRIEF ON REARGUMENT.

Petitioners believe that their Supplemental Brief, filed on reargument, adequately joins issue with Respondent on the questions put by the Court. However, Respondent has filed a single consolidated brief in both the instant case and *Estate of Francois L. Church*, deceased, No. 5, October Term, 1948, and this Reply Brief is filed primarily to keep clear the factual differences between the *Spiegel* and *Church* cases and the different legal consequences which may flow from such factual differences. In addition,

this brief will amplify certain arguments made in our Supplemental Brief.

Facts Distinguishing Spiegel and Church Cases.

Spiegel retained no interest in the income of the trust he created. The income was, from the beginning, paid to or for the benefit of his three children. Church reserved the income of his trust during his lifetime.

Spiegel's three children (the beneficiaries) were alive in 1920 when the trust was set up. They were alive at Spiegel's death in 1940, when the corpus of the trust was distributed to them. Church, at no time, had any children although, if he had had a child, the child would have become a beneficiary of the Church trust.

Spiegel had no power to name a substitute trustee in the event of a vacancy. Church had that power in connection with his trust.

At Spiegel's death and for many years prior thereto, the trust estate consisted of a widely diversified portfolio of stocks and bonds—138 different items at date of death. The Church trust estate consisted, at all times, of stock in a single company.

These facts must be kept in mind in considering Respondent's brief. They serve substantially to distinguish the *Spiegel* from the *Church* case.

Reinecke Should Not Be Overruled.

Respondent's brief is based, so far as the *Spiegel* case is concerned, principally upon his argument that any trust which is distributable upon the death of a settlor necessarily takes, and is intended to take, effect at the death of the settlor and is taxable. Hence, Respondent argues that *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, incorrectly

decided that the Federal estate tax does not apply to an *inter vivos* transfer by which a decedent relinquishes all interest in the trust property, retaining no interest which could cease upon his death.

Fundamentally, Respondent's argument is founded (Br. 22) upon the unsound conclusion that *Reinecke* must fall with the *St. Louis Trust Co.* cases which were overruled by *Hallock*. In our Supplemental Brief (pp. 13-14), we have shown that the dissenting Justices in the *St. Louis Trust Co.* cases based their decision on *Reinecke*. Further, Respondent, himself, did not always believe that *Reinecke* and the *St. Louis Trust Co.* cases must fall together and, in his *Hallock* brief (pp. 24-25), he said:

> "We respectfully submit that when Congress spoke of transfers 'intended to take effect in possession or enjoyment' at or after death, it was simply undertaking to tax transfers that were substitutes for testamentary dispositions, and that it never intended to revivify medieval concepts of property law as a basis for determining taxability. The decisions in the *St. Louis Trust Co.* cases to the contrary stand out in striking contrast to the realistic approach in such cases as *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, *Porter* v. *Commissioner*, 288 U. S. 436, and the *Klein* case, where the shifting of economic benefits at death was held to be sufficient ground upon which to base the tax."

Certainly, Respondent was not urging the Court in *Hallock* to overrule *Reinecke*. (cf. pp. 9-10, *infra*.)

In support of his argument here, Respondent states (Br. 5-9) that the phrase "intended to take effect in possession or enjoyment at or after death" had a history derived from prior state and Federal inheritance and succession taxes, and that that history was adopted by Congress in the first estate tax law, passed in 1916. If Respondent's argument is intended to give the impression that the decisions under state laws were uniform to the effect that a

trust, such as the Spiegel trust (where neither income nor any other interest was retained by the settlor) was taxable as intended to take effect in possession or enjoyment at death, we submit that the argument is not supported by the decisions.

Although state decisions on inheritance or succession tax laws had little, if any, relevancy on the question of construction of the very different estate tax before the Court in *Reinecke* (see Petitioners' Supplemental Brief, pp. 10-11), nevertheless a trust, such as the one before the Court here, would not have been taxable in 1916, or today, under the statutes of many states. Illinois would not hold the trust taxable. *People* v. *Northern Trust Co.*, 330 Ill. 238, 246-8 (1928); *People* v. *McCormick*, 327 Ill. 547, 553, 556 (1927). Likewise, neither Delaware, Michigan, Minnesota, Ohio, Pennsylvania nor Wisconsin would tax the Spiegel trust. See *Highfield* v. *Equitable Trust Co.*, 155 Atl. 724 (Del. Super. Ct., 1931); *State* v. *Welch's Estate*, 209 N. W. 930 (Mich., 1926); *In re Marshall's Estate*, 228 N. W. 920 (Minn., 1930); *Chase* v. *Commissioner*, CCH State Inheritance, Estate and Gift Tax Service (7th Ed.) Dec. No. 16,186 (Minn. B. T. A., 1947); *In re Thompson's Estate*, 68 N. E. 2d 71 (Ohio, 1946); *In re Hazelton's Estate*, 73 N. E. 2d 799 (Ohio, 1947); *In re Dolan's Estate*, 124 Atl. 176 (Pa., 1924); *In re Townsend's Estate*, 36 Atl. 2d 438 (Pa., 1944); *In re Glosser's Estate*, 49 Atl. 2d 401 (Pa., 1946); *In re Prange's Will*, 231 N. W. 271 (Wis., 1930).

Respondent refers (Br. 7, f. n. 3) to his brief in *Hassett* v. *Welch* for a collection of state court authorities on the question. The decisions cited in the Government's *Hassett* brief (p. 22), are stated to stand for the proposition that— (pp. 20-22)

> "* * * such state courts as have had occasion to construe this clause, both before and after the enactment of the Federal law in 1916, have uniformly treated it as including a transfer *in which the transferor has*

retained a life estate, either in form or in substance." (Italics ours.)

While state courts have quite generally held a trust, under which the settlor retains income for his life, to be a transfer intended to take effect in possession or enjoyment at or after death, such decisions have no relevancy here since Spiegel retained no interest in the trust property. It is significant, in this connection, that Respondent's *Reinecke* brief cited no state court authority, holding taxable a trust under which the settlor retained *no* interest (and the *Reinecke* settlor retained no interest).

Respondent cites (Br. 8) *Commissioner* v. *Estate of Holmes,* 326 U. S. 480, for the proposition that the words "enjoyment" and "enjoy" are not terms of art but connote substantial present economic benefit rather than technical vesting of title or estates. In the *Holmes* case, the beneficiaries had no right to immediate enjoyment of income, and the settlor retained the right to terminate, alter or amend the trust. We, accordingly, fail to see the bearing of the *Holmes* case on the case at bar.

Respondent seeks (Br. 11, f. n. 4) confirmation of what he alleges to be Congressional purpose not to confine the statute to "transfers" *from* a decedent at his death in the statutory provision for inclusion in gross estate of interests held jointly by a decedent and another. However, the right of survivorship, inherent in joint tenancies, is certainly a substantial right retained by each joint tenant until his death. Until death, the right of each tenant to succeed to ownership of the entire property does not cease. See *United States* v. *Jacobs,* 306 U. S. 363, 370-71. The joint tenancy cases thus aid the *Reinecke* construction.

In any event, Respondent recognizes that one, who has the income from trust property, has both possession and enjoyment of that property, for he says here (Br. 25):

> "* * * In the *Church* case, the decedent retained during his lifetime the income from the property, that is, *the actual possession and enjoyment* of the property, and hence *the actual possession and enjoyment* of the property could not possibly take effect in the remainderman until his death; * * *." (Italics ours.)

Surely, it must follow that, since the Spiegel *beneficiaries* received, immediately and during Spiegel's lifetime, all income from the property ("that is, *the actual possession and enjoyment of the property*"), the actual possession and enjoyment of the property passed to, and took effect in, the beneficiaries upon the creation of the Spiegel trust.

If the Court's first question is answered in the affirmative, a trust would be taxable upon the death of the settlor if, thereunder, income is to be paid to A (whether relative or stranger) during the life of the settlor and, upon the settlor's death, corpus is to be paid to B, or, if B is not alive, to C, or, if C is not alive, to D, and so on, with a final remainder to the American Red Cross or the United States Government. Such a result would not be justified by any decision of the Court, and is not within the intent of Congress.

Respondent urges (Br. 21, f. n. 8) that overruling *Reinecke* would not be unfair to Petitioners, because, when the Spiegel trust was created, there was outstanding a Regulation which, he argues, made it clear that a retained interest was not indispensable to taxability. His reference is to Article 24 of Regulations 37. The Regulation (only a portion of which is quoted by Respondent—Br. p. 7—and which deals with taxability of transfers involving retained income) says no more than that there can be transfers, intended to take effect in possession or enjoyment at death, even though the transferor has retained no income. This is, of course, true provided the settlor retains some other interest, as typified by the *Hallock* type of cases. It is

clear that the Regulation did not purport to tax a transfer, in connection with which the settlor has retained no interest whatsoever, since it provided that "where the grantor reserves a proportionate part of income, only a corresponding proportion of the property should be included in the gross estate", unless the transfer is in contemplation of death. Thus, taxability was based solely upon the interest *retained* by the grantor. If, however, the Regulation (or the appended Example) provided, as Respondent contends, that there could be a taxable transfer, intended to take effect at death, where the transferor retained neither income nor any other interest in the transferred property, then it does not represent the law in 1920 or today or at any time in between.

In any event, Respondent's argument on fairness, based upon his construction of the Regulation, at best, boils down to this:

> Spiegel should have known in 1920 that, in 1948, the Court would say that it had been in error when, in 1929, it said that the Example did not represent the law.

The statement of the proposition should refute it.

We submit that the *Reinecke* construction of present section 811(c) was correct, was relied upon and confirmed by the dissenting Justices in the *St. Louis Trust Co.* cases and by the Court in *Hallock*, has been confirmed by Congress, and should not now be overruled. See Petitioners' Supplemental Brief, pp. 9-12.

Respondent's Argument Deletes "Intended" from Section 811(c).

Having overruled *Reinecke* and concluded that, under section 811(c), any trust is taxable if it terminates or is distributable at the death of the settlor, Respondent is

given little trouble by the word "intended." He argues that, if a trust terminates at death, that fact, alone, makes the transfer take effect at death and, of course, it must be intended that it terminate at that time. On Respondent's construction, existence or non-existence of a reversion, reverter or any other interest at death becomes of no consequence. We do not believe, however, that the Court will so hold and, so long as *Reinecke* and *Hallock* stand, the word "intended" must be given meaning. If it is not given effect, the statute will mean the same as if the word "intended" had been omitted. See Petitioners' original Brief pp. 36-38.

Respondent has not always deleted the word "intended" by construction. In 1920, when the Spiegel trust was created and for some time thereafter, the Regulations provided that a transfer was taxable "when * * * *intended* to take effect in possession or enjoyment at or after * * * death." Regulations 37 (as amended to December 29, 1919), Article 22. At first blush, this Regulation might seem merely to set out the words of the statute and to throw no light upon the meaning to be given "intended". The Bureau, however, during the period prior to the passage of the Revenue Act of 1924 (which added the counterpart of section 811(d) of the Code, dealing with revocations and similar powers), had construed the provisions of Revenue Acts (which were equivalent to section 811(c) of the Code) as taxing all transfers, which were subject to revocation, alteration or amendment by the donor, even though there was no express reference in the earlier statutes to transfers thus subject. See Regulations 37, Article 25. By T. D. 3487 promulgated in 1923, Respondent amended Article 25 of Regulations 37 to read:

> "Where a transfer by trust or otherwise is subject to revocation by the donor, or the terms thereof may be altered or amended by him, or he reserves to himself the right to take or assume either full or partial con-

trol of the transferred property, or to direct or control the management thereof, *all facts and circumstances bearing upon the donor's intent are to be considered, and if it appears that he intended the transfer to take effect in possession or enjoyment at or after his death,* then the value of the transferred property should be included in the gross estate, unless it further appears that the transfer was a bona fide sale for a fair consideration in money or money's worth." (Italics ours.)

The Treasury Decision, thus, made it clear that the use of the word "intended" by Respondent in the early Regulations was for the purpose of basing liability for tax upon the actual intention of the settlor, as later required by *United States* v. *Wells,* 283 U. S. 102 (1931). The Regulations, as amended by the Treasury Decision, read very much the same as the decisions of the Tax Court. See Petitioners' original Brief pp. 39-40 and Supplemental Brief p. 17.

We submit that the word "intended" in the statute must be given meaning and that, if a transfer was not intended to take effect at death but immediately, it is not taxable under section 811(c).

Overruling May v. Heiner Would Not Affect Reinecke.

Respondent seeks to give the impression that, if *May* v. *Heiner* is overruled, *Reinecke* v. *Northern Trust Co.* must fall with it. He states (Br. 22) that *May* v. *Heiner* is based largely on *Reinecke,* and that (Br. 23) *Reinecke* and *May* v. *Heiner* were placed on a common ground. However, in *Reinecke* (unlike *Heiner*), the settlor retained no income or other right in the trust estate. Fundamentally, the only relationship between *Reinecke* and *Heiner* is that *Heiner* cited and relied upon *Reinecke,* but, as said in Paul, Federal Estate and Gift Taxation—1946 Supplement (p. 152):

"In the former case [*Reinecke*] the Court held that a transfer in trust was not taxable under subsection (c) where the grantor created an interest in income for the benefit of another person, possibly terminable five years after the grantor's death, with remainder over to another. * * * Clearly this situation is distinguishable from a trust reserving a life estate in the grantor, which necessarily postpones the passing of the decedent's enjoyment of the property until death. Certainly the mere fact that Mr. Justice McReynolds cited the *Northern Trust Company* decision in *May* v. *Heiner* does not make the two decisions inseparable companions. Authorities cited by an erroneous decision are not necessarily interred together with it, for the error generally inheres in a misuse of the authorities."

The Courts of Appeal hold that *Hallock* is consistent with *Reinecke* and, hence, that *Reinecke* is still law. See Petitioners' Supplemental Brief p. 14, f. n. 5. Further, all members of the Court in *Helvering* v. *Proctor*, 140 F. 2d 87 (CCA 2d, 1944), although they differed on other questions, agreed that repudiation of *May* v. *Heiner* would not logically call for repudiation of *Reinecke*.

A Trustee May Not Act for His Own Benefit.

Respondent argues (Br. 41, f. n. 20) that, although a trustee owes certain fiduciary obligations to beneficiaries, he may exercise his fiduciary powers in his own interest where there is no violation of the beneficiaries' rights. He cites *Reinecke* v. *Smith*, 289 U. S. 172, for this proposition. The *Smith* decision held only that a trustee is not a fiduciary with respect to a power to revoke in conjunction with the settlor, and, therefore, owes no duty to resist revocation of the trust. The Court, however stated (p. 176-7):

"Of course he owes a duty to the beneficiary to protect the trust *res*, faithfully to administer it, and to distribute the income; but the very fact that he participates in the right of alteration or revocation negati[illegible]

any fiduciary duty to the beneficiary to refrain from exercising the power."

Spiegel had no right, either alone or in conjunction with anyone, to revoke or modify the instant trust, and we fail to see the relevancy of the *Smith* decision.

Instant Trust Does Not Resemble a Testamentary Disposition.

Respondent argues (Br. 51) that the position of the beneficiaries under the Spiegel trust was similar to that of a legatee of a will whose legacy might lapse by his death prior to the testator. There is, however, little similarity between a legatee, who must wait for his legacy until the death of the testator, and the Spiegel beneficiaries who, for more than twenty years while Spiegel was living, received income from over $1,000,000 of securities and whose heirs or legatees were bound to receive trust corpus if the beneficiaries did not.

Further and more important, the position of Spiegel and that of a testator could hardly be more dissimilar. Spiegel gave away all rights to the trust property twenty years before he died. He received none of the fruits thereof and he had nothing more to say about the disposition thereof. There was nothing about the Spiegel trust which made it akin to a testamentary disposition.

We submit that the Court of Appeals should be reversed and the Tax Court affirmed.

Respectfully submitted,

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October 8, 1948.